SUPREME COURT, U.S.
MAR 24 1967
JOHN F. DAVIS, CLERK

No. 37

In the Supreme Court of the United States

OCTOBER TERM, 1967

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC., PETITIONER

v.

C. GORDON ANDERSON, TRUSTEE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

THURGOOD MARSHALL,
Solicitor General,
DANIEL M. FRIEDMAN,
Assistant to the Solicitor General,
Department of Justice,
Washington, D.C. 20530.

PHILIP A. LOOMIS, JR.,
General Counsel,
DAVID FERBER,
Solicitor,
PAUL GONSON,
Special Counsel,
ROBERT P. COX,
THEODORE POSNER,
Attorneys,
Securities and Exchange Commission,
Washington, D.C. 20549.

INDEX

	Page
Statement	1
1. The history of the proceedings	2
2. The claims asserted against the debtor	6
a. The claims of the holders of the Caplan mortgage	6
b. The Merrill-Stevens claim	7
c. The stockholders' claims based on alleged violations of the federal securities laws	8
Discussion	9
Conclusion	22

CITATIONS

Ashbach v. *Kirtley*, 289 F. 2d 159	16, 17
Case v. *Los Angeles Lumber Products Co.*, 308 U.S.106	21
Chicago Rapid Transit Co., In re, 196 F. 2d 484	16, 17
Clark v. *Boston-Continental National Bank*, 84 F. 2d 605	19
Comstock v. *Group of Institutional Investors*, 335 U.S. 211	21
Consolidated Industries, In the matter of, N.D. 312 U.S. 510	18
Conway v. *Silesian-American Corp.*, 186 F. 2d 201	16, 17
F. L. Jacobs, Co., In the Matter of, E.D. Mich., No. 42235	9
Food Town, Inc., In the Matter of, D. Md., No. 11070	22

255-913—67——1

	Page
General United Corp., Inc., In the Matter of, D. Kan. No. 3763–B–1	22
Group of Investors v. *Milwaukee R. Co.*, 318 U.S. 523	18
Inland Gas Corp., In the Matter of, E.D. Ky., No. 115	9
McClelland v. *Greenberg*, 142 F. 2d 245	11
Mosser v. *Darrow*, 341 U.S. 267	15
National Surety Co. v. *Coriell*, 289 U.S. 426	16
Oppenheimer v. *Harriman National Bank & Trust Co.*, 301 U.S. 206	19
Protective Committee, Etc. v. *Anderson*, 334 F. 2d 118	5
Salter v. *Williams*, 244 F. 2d 126	19
TMT Trailer Ferry, Inc. v. *Anderson*, 292 F. 2d 455, *certiorari denied sub nom. Shaffer* v. *Anderson*, 368 U.S. 956	3, 4, 21
United Cigar Stores Co. of America, In re, 82 F. 2d 744	20
United States v. *Anderson*, 334 F. 2d 111, *certiorari denied*, 379 U.S. 879	5
Wolf v. *Weinstein*, 372 U.S. 633	15
Woods v. *City Bank Co.*, 312 U.S. 262	15
Young v. *Higbee Company*, 324 U.S. 204	21
Yuba Consolidated Industries, In the Matter of, N.D. Cal., No. 64103	9
Statutes:	
Bankruptcy Act:	
Section 24	11
25	11
121	11
156	9, 11, 14, 15
158	12, 14
167	13
169	13
174	14, 17
196	13, 20

Statutes—Continued
Bankruptcy Act—Continued
Page
Section 197 13
208 2
221 14
(2) 17
250 11
Miscellaneous:
Fleischer, *"Federal Corporation Law": An Assessment*, 78 Harv. L. Rev. 1146 (1965) 21
Hearings before the House Committee on the Judiciary on H.R. 6439, subsequently amended, reintroduced and reported as H.R. 8046, 75th Cong., 1st Sess 12
H. Rep. No. 1409, 75th Cong., 1st Sess.. 11, 13, 20
S. Rep. No. 1916 on H.R. 8046, 75th Cong., 3d Sess 11

In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 952

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC., PETITIONER

v.

C. GORDON ANDERSON, TRUSTEE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

This memorandum is submitted pursuant to the Court's order of February 13, 1967, inviting the Solicitor General to express the views of the United States in this case.

STATEMENT

This case involves the reorganization under Chapter X of the Bankruptcy Act (11 U.S.C. 501, *et seq.*) of TMT Trailer Ferry, Inc. ("the debtor"). The Securities and Exchange Commission participated as a party in the reorganization proceeding pursuant to

Section 208 of that Act,[1] and for the most part took the same position in the courts below as the petitioner takes here.

1. THE HISTORY OF THE PROCEEDINGS

The debtor, organized in 1954, is engaged in the business of transporting loaded truck trailers and other freight on sea-going vessels between Florida and Puerto Rico. Between 1954 and 1957, it issued more than 4,000,000 shares of its common stock at prices ranging from $1 to $2.50 per share. Almost one-half of these shares were acquired by persons who dominated and controlled the debtor, and who resold the stock to public investors, for up to $4 a share. The reorganization proceeding was initiated in 1957; at that time more than 7,000 public investors owned stock of the debtor (II 580, 584, 609).[2] These stockholders have been excluded from participation in the reorganized corporation on the grounds (1) that the debtor was insolvent[3] and (2) that their claims against the debtor based upon violations of the federal

[1] In Title 11 of the United States Code the numbering of the sections of the Bankruptcy Act comprising Chapter X is higher by 400 than in the Act itself, *i.e.*, Section 208 of that Act is Section 608 of Title 11. We shall use the Bankruptcy Act rather than the Code section numbers.

[2] We shall use the same form of record references that the petitioner uses, *i.e.*, the records in the three appeals to the court of appeals will be cited as "I", "II" and "III", respectively. See Pet., n. 1, p. 2.

[3] In 1962 the district court determined that the going-concern value of the debtor was $2,780,000, as against the claims allowed of approximately $5,400,000 (II 387, 387.6). In 1965 the court, without making any specific finding of value, ruled that the debtor was "more insolvent" than it had been in 1962 (III 266; Pet. App. 19a–20a).

securities laws—violations which, they alleged, entitled them to rank on a parity with general creditors—were untimely made.

Early in 1959 the district court confirmed a plan of reorganization recommended by the Chapter X trustee, respondent Anderson, which would have given control of the corporation to the holders of preferred ship mortgages on the debtor's vessels ("the Caplan mortgage") (II 473, 580).[4] Anderson resigned as trustee to become president of the reorganized debtor (I 38; II 525).

The petitioner stockholders committee appealed from the order of confirmation, challenging "the failure of the trial court to order the trustee to conduct an investigation * * * and [the] failure of the court to conduct a hearing on insolvency of the debtor and to make findings of its assets and prospective earnings" (*TMT Trailer Ferry, Inc.* v. *Anderson,* 292 F. 2d 455, 458 (C.A. 5), certiorari denied *sub nom. Shaffer* v. *Anderson,* 368 U.S. 956). While that appeal was pending, the Commission filed in the district court a petition for an investigation, asserting that "an investigation would disclose that the reorganization plan would be unfair in turning the corporation over to persons, or close associates of persons, who had dealt extensively in the stock of the company in transactions which * * * were of questionable legality * * *" (*id.,* p. 457). At a hearing on objections to consummation of the plan, all the parties agreed that an investigation should be made (*ibid.*).

[4] In the petition these persons sometimes are called the Shaffer-Spitzer group.

Anderson, who had been reinstated as trustee (I 41), conducted an investigation. He concluded that the debtor's business had been "wrecked by gross mismanagement, by unwise and unsound expansion financed primarily through the sale of securities in disregard of the protective provisions of the Securities Act of 1933" (II 584), and that the debtor had claims against holders of the Caplan mortgage based on such mismanagement (II 606, 609, 614). The trustee recommended that the order confirming the 1959 plan be vacated (I 294). The district court vacated the order, and the court of appeals affirmed. *TMT Trailer Ferry, Inc.* v. *Anderson, supra.*

Early in 1962, two new plans of reorganization were proposed (II 41, 637). One plan, known as the "internal plan," provided for reorganization of the debtor by issuance of new common stock to its creditors (II 41.7, 41.10, 694–695). The other plan, known as the cash plan, provided for the sale of the debtor's assets for cash to persons unconnected with the company, and the distribution thereof to the creditors (II 637, 711). Neither plan provided for any participation by the stockholders. The stockholders committee, supported by the Commission, objected to both plans on the ground that the stockholders were improperly excluded and further objected to the internal plan because it contemplated employing the trustee as president of the reorganized company (II 1086, 1087). After hearings on valuation, the district court found that the debtor was insolvent, and approved both plans as fair and equitable and feasible (II 380, 387.5–387.8).

A majority of all classes of creditors (other than the United States, which had a non-tax claim exceeding $900,000) accepted the internal plan (II 388). No acceptances were solicited from the stockholders. In February 1963, the district court confirmed the plan (II 881).

In an appeal from the order of confirmation, the stockholders committee (supported by the Commission) contended that the plan was objectionable because it improperly excluded stockholders and contemplated that the trustee would serve as president of the reorganized company. The court of appeals, without reaching the other issues, held that the latter fact did not invalidate the plan.[5] In a separate appeal by the United States, however, the court held that the plan was defective because it failed to accord priority to the government's claim, and remanded the proceeding to the district court to determine whether the plan would be feasible with a provision for such treatment.[6]

After further hearings, the district court authorized amendments to the plan, primarily to provide for the immediate cash payment of the United States' claim (III 71). The creditors accepted the amended plan (III 316, 325) and, over objections by the committee (III 336) and the Commission (III 325), the district court confirmed it (III 328). The court of appeals affirmed (Pet. App. 6a–13a).

---

[5] *Protective Committee, Etc.* v. *Anderson*, 334 F. 2d 118 (Pet. App. 3a).

[6] *United States* v. *Anderson*, 334 F. 2d 111, certiorari denied, 379 U.S. 879.

2. THE CLAIMS ASSERTED AGAINST THE DEBTOR

a. *The claims of the holders of the Caplan mortgage.* In his report of investigation in which he concluded that the debtor's business had been "wrecked by gross mismanagement" (*supra,* p. 4), the trustee detailed the manner in which the holders of the Caplan mortgage had dominated and controlled the financial affairs of the debtor. He concluded that they appeared to have violated the federal securities laws (II 612); that causes of action existed against them and that the debtor had defenses to their claims (II 606); that their claims should be subordinated to claims of innocent parties (II 614); and that they should be required to account for profits made through taking personal advantage of corporate opportunities (II 609).

After the trustee had filed his report of investigation and the district court had vacated its order confirming the 1959 plan (*supra,* p. 4), both the trustee and the Commission filed objections to the Caplan mortgage claim. They sought to have this claim, in the principal amount of $330,000, either "disallowed in toto or * * * subordinated to the claims of general creditors, including stockholders who were sold TMT stock in violation of the Securities Act of 1933 and the Securities Exchange Act of 1934 * * *." (II 1093, 1096). The district court held no hearing on these objections. The plan that the court ultimately approved and confirmed, however, provided for a "compromise" under which $280,500 (the amount paid for the mortgage) was to be paid in cash

in five annual installments;[7] and interest on the mortgage was to be treated as an unsecured claim (III 272).

b. *The Merrill-Stevens claim.* Merrill-Stevens Dry Dock and Repair Co. ("Merrill-Stevens") filed claims totalling $1,628,284, of which $574,580 allegedly was secured by maritime liens on certain of the debtor's vessels (II 23). More than $1,000,000 of these claims were for the unpaid balance of Merrill-Stevens' charges for the conversion of one of the debtor's vessels from a partially-completed naval ship into a self-propelled trailership. On its maiden voyage a series of boiler failures had caused a breakdown of the vessel, necessitating extensive repairs.

Following an investigation, the Commission in 1961 filed objections to these claims, urged that the trustee investigate them, and suggested that they should be referred to a special master for hearing (II 1093). The Commission concluded that the boiler failures may have resulted from Merrill-Stevens' negligence in performing its work of converting the vessel, and that the debtor therefore might be able to offset against the claims the expenses of repairing the vessel (III 405).

Although the trustee initially sought a reference to a special master for a hearing on the claims (II 862), no such hearing was held. Instead, the trustee subsequently moved for the summary allowance of the Merrill-Stevens claims, on the ground that there was only

[7] The plan later was amended to provide for the immediate payment of $250,000 in cash at the time of consummation, instead of $280,500 over five years (order entered September 21, 1965).

a "remote" possibility of materially reducing them by litigating the objections filed against them (II 22). Despite objections by the stockholders committee, which the Commission supported (II 37, 1042, 1073), the plan ultimately approved and confirmed allowed these claims in full, although the secured portion was reclassified as unsecured. The effect of thus allowing these claims was to give Merrill-Stevens about 40 percent of the common stock of the reorganized company (III 251–252, 282).

c. *The stockholders' claims based on alleged violations of the federal securities laws.* Based substantially on the facts in the trustee's report of investigation, the stockholders committee repeatedly asserted in various ways, including the filing of formal proofs of claim, that non-management stockholders had claims against the debtor, based upon violations of the federal securities laws, that were entitled to parity treatment with the claims of general unsecured creditors—irrespective of the solvency or insolvency of the debtor. It made this contention to the district court in connection with the formulation, approval and confirmation of the plans of reorganization. (II 363, 364, 962, 1037, 1039, 1074, 1083, 1086–1088).

The district court, without an evidentiary hearing, denied these claims (II 379–380). It stated:

> There is nothing in the record of these proceedings to indicate that any stockholders have any claims against the debtor that would permit them to recover on such a theory, which is intended to cover stockholders *who acquired their stock on the open market* and not from

> the debtor * * * and the time for filing claims expired several years ago.
>
> * * * * *
>
> Furthermore, the [Committee's] claim is filed too late and is vague and indefinite as to who the claimants are and the extent and amount of their claims. It is too nebulous to delay reorganization at this stage. [II 379–380, emphasis in original.]

DISCUSSION

In a prior appeal in this case, the court of appeals held in 1964 that "[t]he plan is not to be rejected merely because Anderson, the trustee, would become president of the reorganized company * * *" (Pet. App. 5a). But since, despite that ruling, the trustee might not have become president,[8] the question whether such employment would violate the requirement in Section 156 of the Bankruptcy Act that he be "disinterested" was not then ripe for review. The issue is now ripe, however, since the final plan, which the court of appeals approved, contemplates that the trustee will become president (II 707).[9]

[8] The court of appeals remanded the case for a determination whether the plan would be feasible if the non-tax claims of the United States were given priority, and it recognized that if such a change would render the plan unfeasible, a "new plan, based upon an updated determination of insolvency, can be submitted" (Pet. App. 3a). Under such new plan the trustee might not have become president of the reorganized company.

[9] Although this apparently is the first appellate decision discussing the point, there have been several other cases in which a Chapter X trustee has succeeded as president of the reorganized company. See, *e.g.*, *In the Matter of F. L. Jacobs*, E.D. Mich., No. 42235; *In the Matter of Yuba Consolidated Industries*, N.D. Cal., No. 64103; and *In the Matter of Inland Gas Corp.*, E.D. Ky., No. 115.

The last opinion of the court of appeals seemingly rests on narrow grounds turning on the facts of this particular case—factors that ordinarily would suggest that there is no occasion for further review. Thus the court of appeals, after holding, contrary to the view of the district court, that its decision in the prior appeal "left open those issues not in terms discussed and decided" (Pet. App. 8a), ruled as follows: (1) The district judge had justifiably refused to "consider * * * on their merits" the claims of the stockholders that, based on violations of the federal securities laws, they were entitled to be treated as creditors in the reorganization plan, since he had not "abused his discretion" in concluding that such claims had not been timely filed (Pet. App. 8a–10a). (2) The district court had not erred in approving without a hearing the compromise of "approximately $2,000,000 in two seriously disputed claims" or in ruling, without attempting to value the debtor "when reorganized" (II 170), that it was insolvent both in 1962 and in 1965 (Pet. App. 10a–30a). It explained: "We are not called on to decide whether the district court has accurately computed the going concern value of the debtor and the amount of the creditors' claims, but only whether its decision that the debtor is insolvent is clearly erroneous. * * * The finding of insolvency cannot be held clearly erroneous" (Pet. App. 13a).

We believe that these rulings, however limited their scope may appear initially, in fact rest upon serious misconceptions of the governing standards in Chapter X proceedings, and reflect a failure of the court of appeals adequately to supervise the conduct of this reorganization by the district court. Congress has

recognized the broad supervisory responsibility of courts of appeals in Chapter X proceedings by making applicable to such proceedings the liberal appellate review practice followed in bankruptcy generally. See Sections 24, 25, 121, and 250; *McClelland* v. *Greenberg*, 142 F. 2d 245, 248 (C.A. 2).

The court of appeals apparently was substantially influenced by its view that "[t]his nine-year-old litigation must at long last be brought to an end" (Pet. App. 13a). The Commission is no less concerned than the court of appeals about the delay in this reorganization.[9a] But the desirability of terminating a protracted proceeding certainly does not outweigh the importance of correcting the serious errors that the district court committed in this case.

1. One of the major reforms that Chapter X provided for corporate reorganizations was the requirequirement in Section 156 that "[a]ny trustee appointed under this chapter shall be disinterested * * *." The legislative history of Chapter X shows that Congress contemplated the disinterested trustee would be the "focal point" of the reorganization;[10] that Congress recognized that his functions were "difficult to overemphasize";[11] and that the requirement that he be disinterested was designed to eliminate past reorganization abuses that had resulted from "friendly" trustees.[12] In short, as the Commission (which recommended the legislation) told the

[9a] During the reorganization the debtor has continued to operate, and indeed has expanded its operations (II 310.1, 864).

[10] H. Rep. No. 1409, 75th Cong., 1st Sess. 43 (1937).

[11] *Ibid.*

[12] S. Rep. No. 1916 on H.R. 8046, 75th Cong., 3d Sess. 21 (1938).

Congress, "the independent trustee is the key to real reform. In comparison, the other reforms are secondary."[13]

Section 158 specifies that a person "shall not be deemed disinterested" if he comes within three categories of relationships with the debtor,[14] or if "it appears that he has, by reason of any other direct or indirect relationship to, connection with, or interest in the debtor * * * or for any reason an interest materially adverse to the interests of any class of creditors or stockholders." We submit that a trustee who intends or contemplates that he will become president upon reorganization of the debtor has "an interest materially adverse to the interests" of the creditors and stockholders of the debtor within the meaning of the foregoing provision, and therefore is no longer "disinterested."

Throughout the reorganization the trustee repeatedly is called upon to make recommendations and decisions that vitally affect both the size of the estate and the participation therein of creditors and stockholders. Although the court bears the final responsibility for passing upon all steps in the re-

[13] See testimony of then Commissioner Douglas in *Hearings before the House Committee on the Judiciary* on H.R. 6439, subsequently amended, reintroduced and reported as H.R. 8046, 75th Cong., 1st Sess., 177 (1937).

[14] If he (1) is a creditor or stockholder of the debtor, or (2) is, or was an underwriter of any of the debtor's outstanding securities or within five years had been an underwriter of any of the debtor's securities, or (3) is, or was within two years of the filing of the petition, a director, officer or employee of the debtor or any such underwriter, or an attorney for the debtor or such underwriter.

organization process, the trustee plays a vital role in assisting the court in the proper performance of that function. He conducts any investigation that may be necessary, evaluates and reports upon any claims in favor of the debtor that may thereby be disclosed, recommends the allowance and disallowance of claims against the debtor, generally plays a major role in the formulation of a plan of reorganization, and advises the court on a wide variety of other important matters (see Sections 167, 169, 196, and 197).

Unless the trustee is completely disinterested, however—that is, unless there is a complete absence of any factor that, consciously or unconsciously, might tend to cause personal considerations to influence him—he is not able to provide "an informed judgment and to afford a critical scrutiny and supervision of the estate at all times" [15]—the function that Congress intended him to perform.

In the present case, for example, when two plans of reorganization were proposed in 1962, the trustee recommended to the court the internal plan—which specifically contemplated that he would become president of the reorganized company (Pet. App. 4a) [16]—

[15] H. Rep. No. 1409, 75th Cong., 1st Sess., 43 (1937).

[16] On May 2, 1962, during the hearings on approval of those plans, there was introduced into the record a proposed contract between the reorganized corporation and the trustee, his general manager and his sales manager, whereby the reorganized company would employ them as president, executive vice president and general manager, and vice president and national sales manager, respectively, the first two at $25,000 per year and the third at $17,500 per year (II 275, 296–298). This contract was specifically referred to in the internal plan of reorganization

and opposed the alternative plan for sale of the debtor's assets to third parties. In addition, there were serious objections to claims of two major creditors totalling approximately $2,000,000. The trustee decided not to pursue them and instead recommended a plan which allowed them almost in full and under which one of the creditors (Merrill-Stevens) will receive about 40 percent of the common stock of the reorganized company—an interest that will wield a commanding vote when it comes to selecting the new president. The likelihood that the trustee would become president of the company upon reorganization gave him "an interest materially adverse to the interests" of the public stockholders under Sections 156 and 158, which precluded a finding that the plan of reorganization was "fair and equitable" (Sections 174 and 221).

We do not suggest that the trustee's recommendations on these matters were deliberately designed to promote his personal interest.[17] But the requirement in Section 156 that the trustee be "disinterested" is to avoid even the possibility of such

(II 707). The court of appeals recognized that the contract was "between the major creditors and the trustee" (App. 4a).

The earlier plan that had been confirmed contemplated that Anderson would become the salaried president of the debtor upon its reorganization; and, as noted (*supra*, p. 3), upon confirmation of that plan Anderson resigned as trustee in order to assume that office and a successor trustee was appointed. The latter was subsequently removed before the order of confirmation had been vacated and Anderson was reinstated as trustee (I 40–41).

[17] The district court noted, however, that in considering two plans, one of which provided for his future employment and one of which did not, the trustee "would be perhaps inclined to lean to his employment" (II 332).

conflicts of interest. For the evil is not that "such interests are always corrupt but [that] they are always corrupting." (*Mosser* v. *Darrow*, 341 U.S. 267, 271); "the incidence of a particular conflict of interest can seldom be measured with any degree of certainty" (*Woods* v. *City Bank Co.*, 312 U.S. 262, 268). Cf. *Wolf* v. *Weinstein*, 372 U.S. 633, 642, 654.

The court of appeals seemingly indicated that the touchstone of disinterestedness was whether the proponents of a plan "assured" the trustee of future employment with the debtor or merely intended to recommended it to the court and the board of directors (Pet. App. 4a–5a). Such a distinction would be unworkable in practice, since sophisticated business men would have no difficulty in reaching understandings that stop short of formal agreements. Moreover, it would seriously weaken the protections which the requirement of a disinterested trustee was intended to provide for creditors and stockholders. For the probability of future employment may create just as great a danger of a conflict of interest as its certainty. Section 156 must cover both situations if it is to achieve the salutary purpose that Congress intended it to serve.

2. In affirming the district court's approval of the plan embodying the "compromises" of two substantial claims and upholding the district court's finding of insolvency as not clearly erroneous, the court of appeals (a) departed from the settled principle that compromises in Chapter X proceedings of substantially disputed claims may be approved only on the basis of a complete record that permits an informed

judgment as to the merits of the claims and the basis of the settlement; and (b) failed to follow the standards for determining valuation that this Court has prescribed in corporate reorganizations.

a. Under the confirmed plan the $330,000 Caplan mortgage claim is to be "compromised" by paying the holders thereof $280,500 (the amount they paid therefor) over five years [18] and giving them stock for their interest claims; and the Merrill-Stevens claim of $1,628,284 is to be "compromised" by reclassifying the allegedly secured portion thereof (approximately $575,000) as unsecured, and issuing for the entire claim approximately 40 percent of the common stock of the reorganized company. The record contained no evidence, however, upon which the merits of these claims could have been evaluated, and the district court did not make "an informed independent judgment" (*National Surety Co.* v. *Coriell,* 289 U.S. 426, 436) thereon. The decision of the court of appeals approving the compromise in such circumstances is accordingly inconsistent with such decisions as *Ashbach* v. *Kirtley,* 289 F. 2d 159 (C.A. 8), *In re Chicago Rapid Transit Co.,* 196 F. 2d 484, 488 (C.A. 7), and *Conway* v. *Silesian-American Corp.,* 186 F. 2d 201 (C.A. 2), which recognized that a district court cannot properly appraise the fairness of a compromise of disputed claims in a reorganization without an adequate record thereon.

Thus, in *Ashbach,* the court of appeals reversed an

[18] The plan subsequently was amended to provide for the payment of $250,000 immediately upon consummation. See note 7, *supra,* p. 7.

order of the district court which had approved, after a hearing at which no testimony had been introduced, a compromise settlement of a judgment obtained by the trustee. The court of appeals stated that in the light of the "paucity of information furnished to the court by the trustee and his counsel," "there were too many questions left unanswered for the court to arrive at that 'informed and independent judgment' referred to * * * in *National Surety Co.* [*supra*]" (289 F. 2d at 166). Similarly, in *Conway,* the court of appeals reversed the lower court's approval of a Chapter X plan of reorganization which compromised conflicting claims by a group of Swiss banks, stating "we are compelled to find a lack of sufficient proof of the adequacy of the settlement proposed to justify acceptance of the plan as fulfilling the statutory standards ['fair and equitable' requirements of Sections 174 and 221(2) of Chapter X]" (186 F. 2d at 212). And in *Chicago Rapid Transit,* the court of appeals reversed an order approving a "businessman's settlement" of mutual claims between the debtor and a former lessor because it was made "solely on the basis of expediency and the desire to forestall further lengthy and expensive litigation, with no attempt at considering the relative merits of the conflicting claims of the parties" (196 F. 2d at 485). Similar objections apply to the compromise of the Caplan mortgage and Merrill-Stevens claims in the present case.

b. The district court's error in approving the compromise without an adequate record has a particularly serious impact upon the public stockholders (who

have been excluded from participation in the reorganized company) because of the court's further error in applying an erroneous method of valuation in determining that the debtor was insolvent. This Court repeatedly has stressed that an informed estimate of the future earnings of a reorganized company is essential to a proper determination of valuation. See, *e.g., Consolidated Rock Products Co.* v. *DuBois*, 312 U.S. 510, 526, and *Group of Investors* v. *Milwaukee R. Co.*, 318 U.S. 523, 540. In *Consolidated Rock* this Court, although acknowledging that mathematical precision in predicting future earnings cannot be expected and that an estimate is all that can be made, stated that such estimate "must be based on an informed judgment which embraces all facts relevant to future earning capacity and hence to present worth, including * * * all circumstances which indicate whether or not * * * [the past earnings] record is a reliable criterion of future performance." 312 U.S. at 526.

In the present case, however, the district court failed to follow these principles, and instead used an impermissible method of valuation. The court stated that the debtor is to be valued "as it now exists" (II 170), that "[t]here is [*sic*] no future prospects other than what is going on" (III 55–56), that the "only reliable factors are what the debtor is doing now" (II 387.7), and that its value "when reorganized" is "of no importance" (II 170). In 1962 the district court valued the debtor by simply projecting its existing earnings on the same level for the next several years (II 387.5). This calcu-

lation was improper because it failed to reflect foreseeable increases in revenues that seemed likely because of an increasing demand for the debtor's services, and the likelihood that the trustee would shortly purchase additional vessels and trailers (II 310.1, 864). Moreover, the then current earnings reflected a deduction of reorganization expense which, of course, was not an ordinary business expense (II 267). After the remand of the court of appeals the district court in 1964–1965 did not attempt to make any further valuation of the debtor, but merely concluded on the basis of its then current earnings that it was "more insolvent" than it had been two years previously (III 266).

3. Most of the facts upon which the stockholders' claims rest were first uncovered during the trustee's investigation (*supra,* pp. 4, 6). His report of investigation was filed on July 1, 1960, more than two years after the April 4, 1958, date the district court had set for the filing of claims. On the basis of his investigation, the trustee recognized that "stockholders who were sold TMT stock in violation of the Securities Act of 1933 and the Securities Exchange Act of 1934" had claims as "general creditors" against the debtor (II 1096).[19]

[19] If such stockholder claims can be established, they are entitled to rank on a parity with those of other general unsecured creditors. See *Oppenheimer* v. *Harriman National Bank & Trust Co.*, 301 U.S. 206; *Clark* v. *Boston-Continental National Bank*, 84 F. 2d 605, 607 (C.A. 1); and *Salter* v. *Williams*, 244 Fed. 126, 130 (C.A. 3), cited with approval by this Court in *Oppenheimer.*

Unlike ordinary creditors who, at the outset of a Chapter X proceeding, are aware of their claims against the debtor based upon such matters as credit extended or services performed, the 7,000 stockholders here involved were not aware of their claims based upon alleged violations of the federal securities laws until after the trustee filed his report, long after the commencement of the proceeding. While the facts as to each of the claims may vary, their legal theory involves common questions of law. Accordingly, it would have been appropriate for the trustee, as an "arm of the court",[20] to have devised a procedure pursuant to Section 196 to determine the legal questions before formal proofs of claims would have had to be filed. Moreover, since the original date for the filing of claims had expired before these claims became known, the district court should have at least set a new filing date for them. See *In re United Cigar Stores Co. of America*, 82 F. 2d 744, 745 (C.A. 2), stating that "notwithstanding the expiration of the time limit for filing proofs of claims, the court will grant to a creditor leave to file such proof unless the proceedings have reached such a point that their purpose would be frustrated or substantial rights of other creditors be impaired by such permission."[21]

---

[20] H. Rep. No. 1409, 75th Cong., 1st Sess., 43 (1937).

[21] In ruling that the district court had not abused its discretion in refusing to consider the claims on the merits, the court of appeals stated (Pet. App. 10a): "To allow the filing of additional claims of an unknown number of stockholders, which by their nature might have required years to liquidate and which might have delayed indefinitely the formulation of any plan of reorganization, would have been extremely prejudicial to the creditors." But if, as we have argued, the dis-

When it appeared that the trustee was ignoring these claims, however, the stockholders committee, in March 1961 and on numerous occasions thereafter, formally advised the court of the claims. In June 1962 it filed a proof of claim (II 364), as did a stockholder acting on behalf of all (II 358). Since such claims go "beyond the objector's individual interests and * * * [affect] the fairness and equity of the plan," [22] the district court should have considered them on the merits. For the reorganization court must be "diligent to protect itself and the public from approval of unfair plans, even by default * * *" (*Comstock* v. *Group of Institutional Investors,* 335 U.S. 211, 227).

With the increasing development of private rights of action under the federal securities laws,[23] claims

---

trict court had the obligation to consider the claims, the court's failure to perform that obligation cannot be justified on the ground that to have done so would have caused further delay. Cf. *Case* v. *Los Angeles Lumber Products Co.*, 308 U.S. 106, 114, where this Court pointed out that "All those interested in the [debtor's] estate are entitled to the court's protection." Here, as shown above (*supra*, p. 19, n. 19), if the claims are valid the stockholders are entitled to participate in the estate on a parity with other creditors; and the failure to accord them such participation precluded a finding that the plan was fair and equitable. Moreover, as the court of appeals recognized in one of the earlier appeals in this case, the creditors of the debtor had no vested rights in the plan of reorganization prior to its consummation, and certainly not prior to the time the stockholders committee first made the claims. *TMT Trailer Ferry, Inc.* v. *Anderson*, 292 F. 2d 455 (C.A. 5).

[22] *Comstock* v. *Group of Institutional Investors*, 335 U.S. 211, 227, 235; cf. *Young* v. *Higbee Company*, 324 U.S. 204, 214.

[23] See, *e.g.*, Fleischer, "*Federal Corporation Law*": *An Assessment*, 78 Harv. L. Rev. 1146 (1965).

similar to those asserted by the stockholders here have been, and are being, asserted in other Chapter X proceedings.[24] The rule applied by the district court in this case and approved by the court of appeals would have a seriously inhibiting effect upon the proper judicial evaluation of such claims.

CONCLUSION

The decision of the court of appeals rests upon the application of erroneous legal principles. The issues are of sufficient importance in the administration of Chapter X of the Bankruptcy Act to warrant review by this Court. The petition for a writ of certiorari should therefore be granted.

Respectfully submitted.

THURGOOD MARSHALL,
Solicitor General.

DANIEL M. FRIEDMAN,
Assistant to the Solicitor General.

PHILIP A. LOOMIS, JR.,
General Counsel,

DAVID FERBER,
Solicitor,

PAUL GONSON,
Special Counsel,

ROBERT W. COX,
THEODORE SONDE,
Attorneys,
Securities and Exchange Commission.

MARCH 1967.

[24] See, *e.g.*, *In the Matter of Food Town, Inc.*, Md., No. 11070, and *In the Matter of General United Corporation, Inc.*, D. Kan., No. 3763–B–1.

U.S. GOVERNMENT PRINTING OFFICE: 1967